



DEFENSE CONTRACT AUDIT AGENCY
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

PAS 8-730.1

9 April 1998
98-PAS-062(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on SAS No. 85 "Management Representations"

Statement on Auditing Standards No. 85 (SAS 85) was issued in November 1997 and is effective for audits of financial statements for periods ending on or after 30 June 1998. SAS 85 supersedes SAS 19 (Client Representations) issued in 1979. SAS 85, like its predecessor, requires the independent auditor to obtain written representations from management as a part of an audit of financial statements performed in accordance with GAAS.

SAS 85 does not change DCAA's existing policy. Management representation letters addressed in SAS 85 and SAS 19 are not applicable to the contract audit environment. Their primary purpose, documenting management's acknowledgement of its responsibility for the completeness and accuracy of the financial information presented, is achieved in the contract audit environment through specific certifications required by the FAR, such as:

Final indirect costs (FAR 42.703-2 and FAR 52.242-4)
Current Cost or Pricing Data (FAR 15.403-4 and 15.406-2)
Claims (FAR 33.207(c), (e), and (f))

Because presentation of a false certification or claim to the government carries a criminal penalty, such submissions are inherently more reliable than oral or written management representations.

The enclosed "DCAA Position Paper on Management Representation Letters," originally issued to address SAS 19, has been revised to address SAS 85. It details DCAA's existing and continuing policy. Please direct any questions or concerns you may have to your regional office. Regional offices may address their questions to Mr. Robert Kratochvil, Program Manager, Auditing Standards Division, at (703) 767-3274, fax (703) 767-3234, or E-mail at *pas@hq1.dcaa.mil.

/s/ Robert DiMucci for

Lawrence P. Uhlfelder
Assistant Director
Policy and Plans

Enclosure:

DCAA Position Paper on Management Representation Letters

DISTRIBUTION: C

DCAA Position Paper

Management Representation Letters

Overview

Both AICPA Statement on Auditing Standards No. 85 (SAS 85) and its predecessor, SAS No.19, require the independent auditor to obtain written representations from management as a part of an audit of financial statements performed in accordance with GAAS.

The purpose and intent of SAS 85 is effectively accomplished in the DCAA contract audit environment through required written certifications established by statutes and regulations. GAGAS does not require additional written representations from auditee management.

DCAA Position

Management representation letters addressed in SAS 85 and SAS 19 are not required in the contract audit environment. The primary purpose of such representations is to document management's acknowledgement of its responsibility for the completeness and accuracy of the financial information presented. This purpose is achieved in the contract audit environment through specific certifications required by the FAR, and is enforced through penalties for false certifications and claims. The certifications discussed below are tailored to address the management assertions related to financial information in the contract audit environment. The FAR requires management's certification under penalties imposed under federal statutes.

Certification of Final Indirect Costs

FAR 42.703-2 requires contractors to certify that all costs included in any proposal to establish or modify final indirect rates are allowable in accordance with contract requirements. In addition, FASA codified the certification requirement at 10 U.S.C. 2324(h) and 41 U.S.C. 256(h).

The clause at FAR 52.242-4, Certification of Final Indirect Costs, below, is incorporated into all government solicitations and contracts, (Department of Energy may use an alternate clause), which provide for establishment of final indirect cost rates.

This is to certify that I have reviewed this proposal to establish final indirect cost rates and to the best of my knowledge and belief:

- 1. All costs included in this proposal (identify proposal and date) to establish final indirect cost rates for (identify period covered by rate) are allowable in accordance with the cost principles of the Federal Acquisition Regulation (FAR) and its supplements applicable to the contracts to which the final indirect cost rates will apply; and*
- 2. This proposal does not include any costs which are expressly unallowable under applicable cost principles of the FAR or its supplements.*

Firm: _____

Signature: _____

Name of Certifying Official: _____

Title: _____

Date of Execution: _____ ” [FAR 52.242-4(c)]

DCAA Position Paper Management Representation Letters

Have the certificate signed by an individual of the Contractor's organization at a level no lower than a vice president or chief financial officer of the business segment of the Contractor that submits the proposal. [FAR 52.242-4(a)(3)]

Because this certification requirement is a contract clause backed by penalties, the contractor has specific financial and legal incentives to be responsive.

In accordance with 10 U.S.C. 234(h) and 41 U.S.C. 256(h), a proposal shall not be accepted and no agreement shall be made to establish final indirect cost rates unless the costs have been certified by the contractor. [FAR 42.703-2(a)]

If the contractor has not certified its proposal for final indirect cost rates and a waiver is not appropriate, the contracting officer may unilaterally establish the rates. [FAR 42.703-2(c)(1)]

Rates established unilaterally should be –

- (i) Based on audited historical data or other available data as long as unallowable costs are excluded: and*
- (ii) Set low enough to ensure that unallowable costs will not be reimbursed [FAR 42.703-2(c)(2)]*

The contracting officer should consult with legal counsel to determine appropriate action when a contractor certificate of final indirect costs is thought to be false. [FAR 42.703-2(d)]

10 U.S.C. 234(h) and 41 U.S.C. 256(a) through (d) prescribe penalties for submission of unallowable cost in final cost rate proposals. [FAR 42.703-2(e)]

Certificate of Fixed & Administrative Costs

A similar certification is required by OMB Circular A-21 (FAR 31.3) to assure that fixed and administrative costs for sponsored agreements are proper and in accordance with the agreement documents and approved project budgets. The annual and/or final fiscal reports or vouchers requesting payment under the agreements will include a certification, signed by an authorized official of the university.

This is to certify that to the best of my knowledge and belief:

- (1) I have reviewed the **F&A** cost proposal submitted herewith;*
- (2) All costs included in this proposal [identify date] to establish billing or final **F&A** costs rate for [identify period covered by rate] are allowable in accordance with the requirements of the Federal agreement(s) to which they apply and with the cost principles applicable to those agreements.*
- (3) This proposal does not include any costs which are unallowable under applicable cost principles such as (without limitation): advertising and public relations costs, contributions and*

DCAA Position Paper Management Representation Letters

*donations, entertainment costs, fines and penalties, lobbying costs, and defense of fraud proceedings;
and*

(4) *All costs included in this proposal are properly allocable to Federal agreements on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements.*

*For educational institutions that are required to file a DS-2 in accordance with **Section C.14**, the following statement shall be added to the "Certificate of F&A Costs":*

(5) *The rate proposal is prepared using the same cost accounting practices that are disclosed in the DS-2, including its amendments and revisions, filed with and approved by the cognizant agency.*

I declare under penalty of perjury that the foregoing is true and correct.

Institution: _____

Signature: _____

Name of Official: _____

Title: _____

Date of Execution: _____ [FAR 31.3]

Certificate of Current Cost or Pricing Data

When cost or pricing data are required, the contracting officer shall require the contractor to execute a Certificate of Current Cost or Pricing Data. The certificate states the following:

This is to certify that, to the best of my knowledge and belief, the cost or pricing data (as defined in section 15.401 of the Federal Acquisition Regulation (FAR) and required under FAR subsection 15.403-4) submitted, either actually or by specific identification in writing, to the contracting officer or to the contracting officer's representative in support of _____ are accurate, complete, and current as of _____**. This certification includes the cost or pricing data supporting any advance agreements and forward pricing rate agreements between the offeror and the Government that are part of the proposal.*

Firm _____

Signature _____

Name _____

Title _____

*Date of execution**** _____

** Identify the proposal, request for price adjustment, or other submission involved, giving the appropriate identifying number (e.g., RFP No.).*

*** Insert the day, month, and year when price negotiations were concluded and price agreement was reached or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price.*

**** Insert the day, month, and year of signing, which should be as close as practicable to the date when the price negotiations were concluded and the contract price was agreed to.*

[FAR 15.406-2)]

DCAA Position Paper Management Representation Letters

If the contractor had information reasonably available at the time of agreement showing that the negotiated price was not based on accurate, complete, and current data, the contractor's responsibility is not limited by any lack of personal knowledge of the information on the part of its negotiators. [FAR 15.406-2 (b)]

Data within the contractor's or a subcontractor's organization on matters significant to contractor management and to the Government will be treated as reasonably available. What is significant depends upon the circumstances of each acquisition. [FAR 15.406-2(c)]

Possession of a Certificate of Current Cost or Pricing Data is not a substitute for examining and analyzing the contractor's proposal. [FAR 15.406-2(d)]

Claim Certification Requirements

For claims over \$100,000, the Contract Disputes Act of 1978, as amended (41 U.S.C. 601-613), establishes procedures and requirements for asserting and resolving claims subject to the Act. In addition, the Act provides for:

- (a) the payment of interest on contractor claims;
- (b) certification of contractor claims; and
- (c) a civil penalty for contractor claims that are fraudulent or based on a misrepresentation of fact.

The prime contractor is required to certify as follows

I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable; and that I am duly authorized to certify the claim on behalf of the contractor. [FAR 33.207(c)]

The certification may be executed by any person duly authorized to bind the contractor with respect to the claim. [FAR 33.207(e)]

A defective certification shall not deprive a court or an agency BCA of jurisdiction over that claim. Prior to the entry of a final judgment by a court or a decision by an agency BCA, however, the court or agency BCA shall require a defective certification to be corrected. [FAR 33.207(f)]

Perspective

The primary purpose for obtaining a written representation from management is to document management's acknowledgement of its responsibilities for the completeness and accuracy of the financial information presented.

DCAA Position Paper

Management Representation Letters

Written representations from management ordinarily confirm oral representations explicitly or implicitly given to the auditor, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representation [SAS 85.02]

Assertions are representations by management that are embodied in financial statement components. They can be either explicit or implicit and can be classified according to the following broad categories:

Existence or occurrence

Completeness

Rights and obligations

Valuation or allocation

Presentation and disclosure [SAS 80.03]

In **practice**, representation letters provide low-grade evidence that the auditor has correctly interpreted the evidence obtained from the application of other audit procedures. Essentially, management representations confirm that management is not aware of a body of evidence that the auditor has overlooked or misinterpreted.

Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion. [SAS 85.02]

A client representation letter is a low grade of audit evidence and should never be used as a substitute for performing other audit procedures. The financial statements already constitute written representations by the client; hence, a representation letter does little more than assert that the original representations were correct. [Principles of Auditing, Meigs, Whittington, and Meigs, 7th edition, 1982, p.214]

Conclusion

DCAA fully complies with the requirements of SAS 85 by reliance upon contractor representations made in the specific certifications required by the FAR.